

Editor's note: Reconsideration granted in part, denied in part; decision vacated in part -- See 115 IBLA 397A (Jan. 24, 1991) below.

ARCO OIL AND GAS CO.

IBLA 88-193

Decided August 21, 1990

Appeal from a decision of the Acting Director, Minerals Management Service, denying a transportation allowance based on line-loss gas and in-line fuel use. MMS 87-0228-OCS.

Affirmed in part; set aside in part and remanded.

1. Minerals Management Service: Generally--Oil and Gas: Pipelines: Generally--Oil and Gas Leases: Royalties: Generally--Outer Continental Shelf Lands Act: Oil and Gas Leases

An MMS decision denying a transportation allowance is properly affirmed to the extent that the allowance deducts line losses attributed to the transportation of royalty natural gas from the wellhead of an Outer Continental Shelf oil and gas lease to an onshore delivery point.

2. Minerals Management Service: Generally--Oil and Gas: Pipelines: Generally--Oil and Gas Leases: Royalties: Generally--Outer Continental Shelf Lands Act: Oil and Gas Leases

A transportation allowance deducting a percentage for "gas consumed" may be allowable as a deduction for "lease-use" gas. Where the record is insufficient to determine whether circumstances warrant a "lease-use" gas deduction, a decision by MMS summarily denying the allowance will be set aside and the case remanded to MMS for consideration of the extent to which the transportation allowance represents "lease-use" gas.

APPEARANCES: Gary H. Hoff, Esq., Dallas, Texas, for appellant; Howard W. Chalker, Esq., Peter J. Schaumberg, Esq., Geoffrey Heath, Esq., Office of the Solicitor, U.S. Department of the Interior, for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE HUGHES

Arco Oil and Gas Company (ARCO) appeals from a decision of the Acting Director, Minerals Management Service (MMS), dated November 6, 1987, affirming an order by the Chief, Royalty Valuation and Standards Division (RVSD), Royalty Management Program, MMS, denying that part of ARCO's transportation

allowance requests attributable to "fuel consumed" and to "unaccounted-for gas lost from the transporter's pipeline system." These items were together characterized as the "non-monetary component" of ARCO's transportation expenses for royalty gas produced from Outer Continental Shelf (OCS) oil and gas leases Nos. OCS-G 6155 and OCS-G 6156, High Island Blocks 115 and 116 located in the Gulf of Mexico.

The following facts appear in the record and are not disputed. The leases were issued pursuant to section 8 of the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. § 1337 (1982). ARCO is the operator for these leases. The gas is metered at High Island Block 116. Production from these leases flows through a 16-inch pipeline, which runs from the High Island Block 116 "A" platform to a subsea tie-in point with a 16-inch Natural Gas Pipeline Company of America (NGPL) pipeline located in High Island Block 71. Sales and deliveries of the gas occur at several points, including the metering point, as well as various contractual sales delivery points subsequent to leaving the platform.

Pursuant to an arm's-length contract dated September 11, 1986, NGPL transports the gas from High Island Block 71 to various delivery points. Under the contract, ARCO is obligated to pay transportation costs to NGPL. The transportation costs are comprised of two components: First, ARCO must pay a monetary transportation fee ("monetary component"). Second, NGPL is authorized to deliver less gas than it receives from ARCO. This latter "non-monetary component" is described in paragraph 2.1 of the contract:

[T]ransporter [NGPL] shall deliver or cause to be delivered to Customer [ARCO], or to a mutually agreeable third party for Customer's account, at the Transporter Delivery Point/s described in Exhibit B hereto, volumes of gas containing a number of Balancing Units, equal to the number of Balancing Units contained in the volumes of gas which are received by Transporter at the Transporter Receipt Point/s, less a percentage for fuel consumed and a percentage for unaccounted for gas lost from Transporter's pipeline system.

Thus, NGPL is permitted to deduct a percentage of the gas for "fuel consumed" and for "unaccounted for gas lost in [NGPL's] pipeline system."

By letter dated February 2, 1987, ARCO requested that MMS grant a transportation allowance based on both the monetary and non-monetary components of its transportation costs. In its letter dated March 12, 1987, the Chief, RVSD, authorized ARCO to deduct the monetary component of the transportation fee, but advised ARCO that royalty was due on the "Percent-age Reduction Fuel/Gas Lost and Unaccounted For" amounts stated in the agreement with NGPL, *i.e.*, the "non-monetary component" described above. By letter dated April 9, 1987, ARCO appealed that portion of the order denying deduction of this non-monetary component to the Director, MMS.

By decision dated November 6, 1987, the Acting Director denied ARCO's appeal. The Acting Director acknowledged that reasonable costs incurred by a lessee in transporting lease production to the nearest available market is one of the "relevant matters" to be considered in establishing royalty value under 30 CFR 206.150 (1986). However, he affirmed the denial of a transportation allowance for the non-monetary component, explaining that, for OCS leases, the measuring point establishing the royalty volume is determined by personnel at the regional OCS office, and that royalty is due on 100 percent of the gas volume measured at that point without a deduction based on line losses incurred during transportation.

Additionally, noting that a lessee may properly be required to pay royalties on oil and gas used for purposes of production outside the producing lease or unit, the Acting Director found that the fuel gas in question is used by NGPL outside the lease pursuant to an agreement with ARCO, and held that ARCO was therefore required to pay royalties on it. The Acting Director also held that the fact that the charges by NGPL for in-line fuel use and line-loss gas were based on a tariff approved by the Federal Energy Regulatory Commission (FERC) did not require approval of deduction of such charges by MMS. ARCO appealed to this Board.

[1] The portion of the non-monetary component described as "unaccounted for gas lost from Transporter's pipeline system" may be described as "line-loss" gas. ^{1/} It is established that line losses attributed to the transportation of royalty oil via pipeline from the wellhead of an OCS oil and gas lease to an onshore delivery point are not deductible as a transportation allowance. 30 CFR 202.150(a); Conoco, Inc., 103 IBLA 108 (1988). Neither the OCS lease nor OCSLA mentions line loss allowances, either for oil or gas. See Conoco, Inc., *supra* at 109. MMS argues that no distinction between oil and gas may be made in considering whether to allow deductions for line losses, and notes that "MMS has used the long established concept established by [30 CFR 202.150(a) (1987)] in determining transportation allowances for gas." Thus, MMS argues, as is the case for oil, no deduction may be made for line losses associated with the shipment of gas through a pipeline. Appellant has not disputed MMS' assertion and has not persuaded us to adopt a variant rule for natural gas.

Although appellant argues that the line loss is reasonable because it is part of the FERC tariff for the pipeline used to transport the gas, this fact is not controlling. See Conoco, Inc., *supra* at 110. We recognize that 30 CFR 206.157(f) currently provides otherwise. ^{2/} However, as MMS points out, the revised gas valuation regulations, which became effective March 1, 1988, expressly state that "[t]hese regulations will apply prospectively to gas production on or after the effective date of this rule."

^{1/} Appellant describes this gas as "gas lost" (Statement of Reasons at 2).

^{2/} Although 30 CFR 206.157(f) (1989) generally disallows deduction of costs for "actual or theoretical losses," it is expressly provided that "this section does not apply when the transportation allowance is based upon a FERC or state regulatory agency approved tariff."

53 FR 1230 (Jan. 15, 1988). Thus, the provisions of the revised regulations are irrelevant. It would be inequitable to grant appeals, based on the new regulations, while denying the same benefits to those who did not appeal MMS decisions.

Appellant argues that NGPL's contractual right to use in-kind gas constitutes partial consideration for transportation of lessor's and lessee's gas to the point of sale. ARCO urges that the terms of the contract must be read in their entirety, recognizing both the monetary and non-monetary components. ARCO reasons that since both components are legally equivalent, the Acting Director's failure to recognize the non-monetary consideration is insupportable and an abuse of his discretion.

We do not dispute that the contract places the burden of paying for line losses on appellant. However, the fact that the producer agrees to bear a cost does not mean that it is automatically deductible from the value of production, which is used to calculate royalty. To the contrary, it is by now well established that only such allowances as have been expressly recognized may properly be deducted from value for royalty purposes. Line losses have not been so recognized and, thus, may not be deducted. Presumably, the so-called monetary component of the transportation allowance, which MMS allowed, was properly cognizable, and is thus distinguished.

[2] Appellant attributes a portion of the non-monetary component at issue herein to "fuel consumed," which apparently has been accepted by MMS as "lease-use" gas or "fuel-use" gas. ^{3/} Unlike for line-loss gas, it is recognized that a deduction for fuel-use gas is appropriate in some circumstances. The Acting Director denied any deduction for fuel-use gas, stating that "[c]learly the fuel gas is used by NGPL outside the producing lease or unit." ^{4/} However, we have declined to affirm a decision by MMS denying a

^{3/} "Lease-use" gas has been defined as follows: "Gas produced pursuant to a lease or unit agreement and used for operations or production activities pursuant to that same lease or unit agreement as a fuel or otherwise in the operation of machinery or equipment." Paragraph 3.A.(2), Notice to Lessees 74-20 (Oct. 25, 1974).

Appellant refers to this gas as "fuel-use" gas. MMS refers to it as "fuel-use gas consumed by NGPL." This terms suggests that the gas was used as fuel, presumably as described above.

For simplicity, we shall refer to this gas as "fuel-use" gas.

^{4/} The Acting Director also stated that appellant "concedes that a 'lessee may properly be required to pay royalties on oil and gas used for purposes of production and operations outside the producing lease or unit.'" Appellant states that the Acting Director has misconstrued its position on this point. By way of example, it notes that it would not object to paying royalty on Federal gas that it used to run compressors on another lease. Appellant stresses that it is not using the gas at issue here for its own benefit to the detriment of the Federal Government. Thus, it suggests that it is using the gas for the benefit of production of gas from this lease. Appellant implicitly argues that gas used as fuel for the benefit of production from the lease should not be subject to royalty.

deduction for fuel-use gas based solely on the fact that the gas was used off lease. Exxon Co., U.S.A., 98 IBLA 218, 94 I.D. 329 (1987). 5/ Accordingly, we are unpersuaded that no deduction was in order, even though the fuel-use gas may have been used by NGPL outside the producing lease or unit.

The present record, however, provides little on which to make a dispositive holding concerning the circumstances surrounding the use of the gas, and we are therefore unwilling to address this question in the context of this appeal. In the absence of a more certain depiction of the circumstances that prevailed in this dispute, including a determination as to how much of the fuel-use portion was used for the benefit of production from the lease, we deem it necessary to set aside the Acting Director's decision to the extent it denied the fuel-use component of the non-monetary portion of the transportation allowance, and to remand the matter to MMS to adjudicate the deductibility of any fuel-use gas in light of our holding in Exxon Co. U.S.A., supra. Any adverse decision will be subject to appeal to this Board.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed in part, set aside in part, and remanded for further proceedings.

David L. Hughes
Administrative Judge

I concur:

John H. Kelly
Administrative Judge

5/ In Exxon Co., U.S.A., supra, we referred for a hearing the issue whether oil or gas (or both) was exempted by the Department before July 1, 1974, from the payment of royalties if used for production or operations outside the lease or unit area from which it was produced. This fact was deemed relevant to whether there was an established practice governing deductions for off-lease-use gas. Id. at 235. We also noted that, if there was no evidence of an established practice, the Administrative Law Judge who considered the matter should consider the issue of whether off-lease-use gas was deductible as a matter of first impression. Id. at 235 note 28. The dispute in Exxon Co., U.S.A., was settled before any ruling was made on the deductibility of off-lease-use gas.

January 24, 1991

IBLA 88-193	:	MMS 87-0227-OCS
	:	
ARCO OIL AND GAS CO.	:	Offshore Oil and Gas Lease
	:	Royalties
115 IBLA 393 (1990)	:	
	:	Petition for Reconsideration
	:	Granted in Part and
	:	Denied in Part
	:	
	:	Decision Vacated in Part
	:	
	:	Case Remanded

ORDER

On October 5, 1990, ARCO Oil and Gas Co. (ARCO) filed a petition for reconsideration of our opinion in ARCO Oil and Gas Co., 115 IBLA 393 (1990), which affirmed in part, set aside in part, and remanded a decision by the Director, Minerals Management Service (MMS).

The Director's decision (MMS 87-0227-OCS) had denied ARCO's request for a transportation allowance on two leases, OCS-G 6155 and OCS-G 6156, High Island Blocks 115 and 116, located in the Gulf of Mexico. Our decision concerned two separate issues: (1) the deductibility of non-monetary (in-kind) payments for gas lost during transportation of gas produced from ARCO's wells ("line-loss gas"); and (2) the deductibility of such payments for gas consumed for purposes of production ("fuel-use gas"). We affirmed MMS' denial of a deduction for line-loss gas, ruling (as argued by MMS) that Departmental regulations governing line losses of oil (30 CFR 202.150(a) (1987)) should apply equally to line losses of gas, and that the amended gas royalty valuation regulations, 30 CFR Part 206, Subpart D (1988), do not apply retroactively to this production. Id. at 395-96. We set aside MMS' denial of the deduction for fuel-use gas, ruling that the record did not support MMS' summary denial of the deduction. Id. at 396-97.

In its petition, ARCO argues that, in the absence of a regulation specifically disallowing line-loss deductions for gas, it was error to deny such deduction here. ARCO also argues that it is entitled to a deduction for both line-loss and fuel-use components because both had been approved by the Federal Energy Regulatory Commission (FERC) as part of the transportation

115 IBLA 397A

company's tariff. ARCO argues that we failed to follow our "established policy of applying amended regulations retroactively where the amendment benefits an appellant and no countervailing public policy reasons or intervening rights exist." Finally, ARCO argues that we are bound to allow the non-monetary deduction because the monetary ("cash") "consideration was considered an acceptable cost by the MMS and IBLA," and that if ARCO had simply presented a total dollar figure representing all components of the transportation charges, the costs would have been an acceptable transportation allowance.

On December 7, 1990, MMS responded to ARCO's petition for reconsideration. ^{1/} In its response, MMS effectively requested that we vacate our decision insofar as it affirmed MMS' determination that the deduction for line-loss gas was improper. MMS explained that it now believes that "in circumstances such as ARCO's, the policy that is most consistent with MMS's valuation philosophy is to grant the transportation allowance associated with line losses incurred under an arm's length contract. * * * Because there was no regulation that specifically applied to line losses for gas during the relevant time period and ARCO's line available market," MMS wishes to grant ARCO a transportation allowance for these costs. MMS did not address the deductibility of the fuel-use gas.

On December 20, 1990, ARCO filed a supplemental pleading urging us to amend our decision to specifically grant it a transportation allowance for the "fuel-use" component of its non-monetary payment. ARCO provided a copy of the decision by the Director in Marathon Oil Co., MMS 89-0178-OCS (Dec. 15, 1989), and asserted that our deductibility for fuel use "than does the MMS Director" and that, "pursuant to Marathon, the calculations discussed by IBLA would be unnecessary since fuel use constitutes an allowable deduction for transportation." ARCO urges us to amend our decision "to grant ARCO a transportation allowance for" the fuel-use gas component for Leases OSC-G 6155 and -56.

While we question why MMS did not advise us of its evident change of position regarding the deductibility of line-loss gas prior to our issuing the decision in question, we perceive no basis for preventing it from reconsidering its denial of this deduction. The appropriate action here is to vacate our decision affirming the Director's denial of this deduction and remand the matter to him for further consideration. This action is not opposed by appellant. In so doing, we make no comment on the propriety of MMS' retroactive application of its policy on line-loss gas or its consistency with the proviso that the 1988 regulations (which adopted a similar policy) apply prospectively.

^{1/} The response was dated Nov. 6, 1990, but filing was unaccountably delayed until Dec. 7, 1990.

only. 53 FR 1230 (Jan. 15, 1988). Such issue would be properly addressed in the context of any appeal disputing MMS' application of its policy.

Vacating our decision insofar as it affirmed the disapproval of line-loss deduction moots some of the issues raised in ARCO's petition. Other issues must be addressed in connection with ARCO's challenge to our disposition of the deductibility of fuel-use gas.

We are not persuaded, as suggested by ARCO, that the deduction of the entire non-monetary portion of the allowance should be allowed because MMS allowed the deduction for the monetary portion. We do not accept ARCO's assertion that, if it had simply presented a total dollar figure representing all components of the transportation charges, the costs would have been acceptable transportation charges, the costs would have been an acceptable transportation allowance. The nature of the payment, whether cash or in-kind, is irrelevant to its deductibility as a cognizable expense. As MMS did not deny the monetary portion, ARCO's appeal did not concern this action, and its deductibility was not before us. As a result, the monetary portion was presumed to be cognizable and, thus distinguishable from the non-monetary portion. Id. at 396. ARCO has failed to show that there was no distinction between the non-monetary and the monetary components, either on appeal or on reconsideration. In the absence of such showing, we need not to consider whether MMS would be bound by its approval of the latter to approve the former as well.

Contrary to ARCO's suggestion, we do not regard the Director's decision in Marathon Oil Co., supra, as demonstrating that MMS has adopted a policy that all decisions for fuel-use gas will be affirmed without question. The decision does not rule that the approval by FERC of a tariff including fuel-use deductions is controlling. Rather, it simply indicates that MMS will allow a deduction for "the reasonable actual costs of transportation," provided that "such costs [are] clearly identified and documented." This appears consistent with our holding in ARCO Oil and Gas Co., supra. As ARCO has conceded, there must be some limit on the deduction, as, for example, where the gas is used to benefit production on another lease. Id. at 396 n.4. Thus, we held that the Director must, at least, determine whether the gas was used as alleged by ARCO for the benefit of production from the leases in question. Id. at 397. We see nothing to the contrary in the Director's decision in Marathon.

By setting aside the Director's decision, we returned the matter to his jurisdiction to re-determine the validity of the fuel-use deduction. Not only was the issue of whether the deduction was proper or improper left unresolved, but no specific methodology was specified, other than to hold that a deduction for fuel-gas could not be disallowed simply because the gas

was used off lease. ^{2/} Our decision in ARCO placed the matter of the deductibility of fuel-use gas before the Director, and it is now up to him to consider whether it is allowable. If he denies this deduction again, ARCO may appeal to this Board anew.

In sum, in ARCO Oil and Gas Co., supra, we set aside the Director's decision, ruling that it was not possible to make a dispositive holding concerning whether ARCO's deduction for fuel-gas were proper based on the record presented to use by MMS. No further action is necessary to empower the Director to address the deductibility of the "fuel-use" gas in this matter. We still have no indication that ARCO is entitled to such deduction and therefore decline its invitation to rule that it is. ARCO's petition is denied insofar as it requests that we modify our decision to allow the fuel-gas deduction.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the petition for reconsideration is granted in part and denied in part. Our decision in ARCO, supra, is hereby vacated to the extent it affirmed the Director's denial of the deduction for line-loss gas, and the case is remanded to the Director for further consideration of this question, joining our previous remand for further consideration of the deductibility of fuel-use gas.

David L. Hughes
Administrative Judge

I concur:

John H. Kelly
Administrative Judge

^{2/} Although we cited Exxon Co. U.S.A., 98 IBLA 218, 94 I.D. 329 (1987), we noted that this case had been settled without a dispositive ruling on the question of the propriety of any deduction of off-lease-use gas.

